

**EXECUTIVE SECRETARIAT**  
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Remarks

Executive Secretary

7 August 85

Date

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Executive Registry	
85-	3103

7 August 1985

MEMORANDUM FOR: Deputy Director of Intelligence  
FROM: Director of Central Intelligence  
SUBJECT: Office of European Analysis

I like the research program for the Office of European Analysis. My only suggestion would be that some of the products would be useful if they could be made available early in the year. I cite the title "Scheduled Projects" and list them in the importance of their availability being advanced.

- Western Europe: High Technology Initiatives and Implications for Defense - Fourth
- NATO: Alternative Defense Strategies - Third
- European Capabilities to Support an ATBM Program: Sensor and Missile Technologies - Third
- The Polish Underground - Third



William J. Casey

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*22 + 10 min*

Office of European Analysis

Nearly all of EURA's research on Europe, both East and West, is conditioned by a growing perception among our consumers that old and comfortable assumptions no longer apply. The conventional verities in Eastern Europe involved the notion that nothing much was happening to affect Soviet hegemony; in Western Europe they centered on the belief that our Allies could more or less be counted on to work in harness with the United States. In the wake of Poland, the East European debt crisis, and pulling and hauling with the West. Europeans over issues as diverse as INF, export policy, and the Middle East, few today would put much stock in either aspect of the conventional wisdom.

For Western Europe, the old generalities have been replaced by a realization that US relations with the Allies are contingent on an enormous array of interconnected variables, some of them divisive, some of them not. Moreover, US objectives themselves often are at odds with each other:

- It is in the US interest that Western Europe have the economic strength to maintain its independence and support a substantial defense effort, but at the same time we worry about competition from the West Europeans in international markets and about the growth of trade between Western Europe and the East.
- Our major allies sometimes seem to be getting better at cooperating among themselves, and it is not at all clear that intra-European cooperation is always in the interest of the United States.
- The contributions of West European defense industries have benefited the United States and the Alliance over the years, and we are encouraging West European participation in the Strategic Defense Initiative. But again we worry (and often have evidence to support the worry) that the West Europeans will operate at cross purposes with the United States in the defense-industries area.

The same sorts of conflicting concerns apply to specific countries. For instance, the United States applauded the accession of democratic rule in Greece and worried over its prospects in Turkey; yet democracy in Greece has produced a government profoundly unsettling to the United States, while Turkey's foreign policy has changed relatively little over several years of domestic political uncertainty.

In Eastern Europe the issues are equally complex: To what extent should the United States encourage the East Europeans' independence of Moscow? Are enhanced ties between Eastern and Western Europe (and East and West Germany in particular) a good thing? If Moscow puts the economic squeeze on Eastern Europe, can the West use trade and credits to take advantage of any opportuni-

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ties without benefiting the USSR? What is the best way to help Yugoslavia deal with its myriad problems?

The questions get harder in both regions when one tries to look farther out and tackle more general issues: What will the Alliance look like in the 1990s? Are political combinations within West European countries likely to become more unstable? Are the West Europeans likely to grow less responsive to US initiatives? What changes will the new Soviet leadership stimulate in Eastern Europe, and what will be the resulting challenges and opportunities for the United States?

Useful answers to questions of this sort require a combination of detail and breadth. At the detailed level, we have embarked on a joint effort with SOVA to clarify the economic links between Eastern Europe and the Soviet Union. We also are developing data at the micro level on several aspects of West European economic activity, with emphasis on the region's defense industries. On the political side, EURA is continuing to expand its store of databases, notably those involved with polling and generational change. We will be building on these data sources in a wide range of somewhat broader projects--for example, a study of a newly assertive trend in Italian foreign policy, a joint project with OGI on the machine-tool industry, and papers on regionalism in Yugoslavia, social unrest in Czechoslovakia, and investment policies throughout Western Europe. Finally, EURA will produce papers assessing the two analytical issues that are critical to the region: the effect of the Gorbachev succession on Eastern Europe, and the degree of assertiveness that can be anticipated from the West Europeans in their dealings with the United States.

EURA has organized its research effort under seven themes (in addition to our involvement with Intelligence Community production). Three of these focus on factors that underlie strains in West European relations with the United States; one deals with terrorism and narcotics, also mainly in Western Europe. ~~(but including one study of Eastern Europe as well.)~~ Three themes concern Eastern Europe. Here we have singled out the region's economic relationship with the USSR for treatment as a separate theme, and we have also undertaken a comprehensive effort on the political and economic milieu in which the new sense of uncertainty has emerged. Under all seven topics, of course, we will be alert for the "far-out" implications in both the temporal and the analytical sense--as we were, for example, in our 1985 study of the impact of demographic changes on West German political parties. In addition we will continue to be heavily involved in Intelligence Community production under the aegis of the National Intelligence Council.

EURA's research themes for FY1986 are the following:

The West European Economies: Structural Problems, Competitiveness, and *Growth*  
 Political Challenges to the US-West European Connection  
 Western European Defense Capabilities and Cooperation

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Counterterrorism and Narcotics  
Eastern Europe's Links with the USSR  
The East European Economies: Reform, Discipline, or Status Quo?  
Political Stability and Instability in Eastern Europe  
Contributions to Intelligence Community Work

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### The West European Economies: Structural Problems, Competitiveness, and Growth

Following more than a decade of slow growth and steady rises in unemployment, most West Europeans--and most analysts of West European economies--now agree that their problems go well beyond the business cycle and well beyond outside-force considerations such as high oil prices, fluctuating exchange rates, or trade barriers. Faced with uncertain (at best) demand and growing competition in the industrial mainstays of steel, shipbuilding, automobiles, textiles, and chemicals, West Europeans appear increasingly concerned about their ability to move into new high-growth/high-employment areas of services or into new high-tech areas that offer productivity and trade competitiveness spinoffs. West European publics, thus far remarkably patient with cautious, anti-inflationary policies, are becoming increasingly restive. The situation could produce ill-planned policy reversals (along the lines France tried in 1981), major increases in protectionism and government intervention, or "throw-the-rascals-out" pressures in the many national elections scheduled over the next few years.

In 1986, for the third year, EURA will focus its economic analysis of Western Europe on the region's structural problems. We will continue to build on previous studies, such as demographic trends and other fundamental factors underlying unemployment; to expand and improve our econometric model, the Linked Policy Impact Model (LPIM); and in general to exploit a growing body of outside research and opinion that has appeared because of increasing concern about the impact of Western Europe's structural problems on the Western Alliance.

EURA's efforts will become even more multidisciplinary and multioffice. For example, much of EURA's planned economic research on Western Europe--and a portion of our economic work on Eastern Europe as well--is part of the Directorate's Cross-Cutting Theme on Structural Change. This approach should facilitate cooperation between country and technical experts, improve inter-regional comparative studies, and increase already-extensive communication and coordination with government agencies, academics, and consultants. Studies grouped under this theme will also benefit from EURA's and OGI's research on defense-related industries.

A series of interagency meetings is underway to share information on others' research. State and OECD plan a joint paper on demographic trends; Treasury is hoping to do a paper on capital market restrictions; and the US Mission to the EC plans to submit a study on European regulations concerning financial institutions. In addition, the OECD, in conjunction with the annual Economic Summits, has been asked to look more deeply into the overall issue of West European structural change. The subject is likely to be a key topic for discussion at the 1986 Tokyo Economic Summit, which should increase the importance of coordination of analysis within the US Government.

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As in the past, EURA's program will focus on basic government decisions and policies to change the region's industrial base and create new jobs. We will approach the issue from several angles: building on preliminary 1985 research into the role of microeconomic variables such as venture capital in promoting technological entrepreneurship; looking at specific industrial sector prospects regionwide, such as automobiles; investigating the role of individual governments and the European Community in promoting (or discouraging) economic progress; judging the political/economic pressures for change; and evaluating, with the help of econometric models, the benefits and trade-offs in various macro and micro policy choices. As governments face the growing restructuring/employment challenge (and as elections loom), EURA's studies on the pressures or attitudes that underlie policy decisions will become increasingly important. These studies, at least one of which is planned on each of the four major countries, will also help to explain evolving West European policies toward the US Strategic Defense Initiative, the French proposal for a European program (EUREKA), and US-European space programs.

The Linked Policy Impact Model, which links econometrically the individual economies of the seven major industrial countries with each other and with the rest of the world, will continue to play a vital-- although largely silent-- role. The model is particularly useful in answering "what-if" questions by predicting the economic impact of real or anticipated changes in policy (a tax cut, for example) or economic forces (such as an oil price change or a shift in exchange rates). In 1985, the LPIM was an essential input into finished intelligence on the potential impact of a precipitous decline of the dollar, on the role of US import demand in world economic activity, and on various potential aspects of falling oil prices. The model was also used to run several last-minute simulations for US delegates to the Bonn Economic Summit.

In the continuing effort to keep the model up to date and to improve its functioning, this year we completed a data base revision, reestimated all the equations, worked up total documentation for the model, and submitted it to leading academics for review. The aggregate model for the smaller countries was also completely respecified to improve its trade linkages. In 1986, we plan to further strengthen the European country models' government and financial sectors so that we can better gauge the impact of policy alternatives; we also plan to develop linkages between input-output models for the major European countries and the LPIM to be able to address directly industrial policy and employment issues. Research under this theme responds to NITs 17D, 17F, and 17G.

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### West European Defense Capabilities and Cooperation

In FY85, we focused on the prospects for NATO force modernization and enhanced European defense cooperation. With the resumption of US-Soviet arms control negotiations in Geneva, we also assessed European policy developments related to INF, NATO theater nuclear weapons stockpile reductions and modernization, and the Strategic Defense Initiative.

EURAs research in this area in FY86 will continue to focus on the broad issue of West European security cooperation and its long-term implications for the Alliance. Primary emphasis, however, will be placed on the question of enhanced armaments cooperation and the capabilities of Western European defense industries to support NATO conventional force modernization and the Strategic Defense Initiative. Research under this theme is responsive to NITs 4E and 17.

Defense Industrial Cooperation: Programs and Capabilities. Building on efforts begun last year, in cooperation with OGI, to assess the long-term defense industrial capabilities of the European Allies, we will undertake industry-specific studies as well as broader structural analyses of industrial cooperation and weapons acquisition in Europe. We also will investigate defense industries in specific countries, beginning with Italy. Our research and analysis in these areas will be supported by a major data base building effort--focused on defense industry capabilities, defense industrial cooperation programs, and defense economics. Several contractor studies will provide in-depth, technical assessments of specific industrial sectors and European capabilities in areas of critical importance to both conventional force modernization (such as emerging technologies) and the Strategic Defense Initiative. In addition to the intelligence assessments scheduled below, this research and data base building will support what we expect to be a large number of ad hoc, quick-response policy support papers on various aspects of West European participation in SDI and in the French-proposed alternative, EUREKA.

NATO Force Capabilities: Meeting the Challenge of the 1990s. Our research on NATO military issues will move away from country-specific assessments into broader issues such as European perspectives on alternative defense strategies. We will continue our work on NATO air defense modernization, and we will assess the impact of demographic trends in Europe on Allied capabilities to meet military manpower requirements through the end of the century. In addition, we will continue our research on the impact of defense spending constraints on European conventional force modernization. Finally, we will initiate a broad research effort to assess the overall readiness of NATO ground forces in the Central Region. In conjunction with DIA, the Army, and the Air Force, we also will continue to develop the NATO Force Trends Data base, an automated tool for the analysis of force and equipment trends over time. This data base will support a joint paper with SOVA on Moscow's perceptions of the NATO-Warsaw Pact balance in Central Europe.

European Security Cooperation. Regional and country-specific studies on broad security issues will focus on such topics as relations among the Europeans and Japan, Spain's role in the Alliance and its contribution to Western security, the question of the flagging security consensus in the Benelux nations, and the evolution of Allied political thought on strategic issues, particularly SDI.

European Perspectives on Arms Control. EURA will continue to provide extensive support to the arms control community, primarily of a quick-response nature, focusing on Allied policy in the various arms control forums. Major papers will address the prospects for INF missile deployments in the Netherlands and the overall arms control policy establishment and process in Europe. Exploratory research will continue to focus on the MBFR negotiations and the Conference on Disarmament in Europe as well as European attitudes on the chemical weapons issue.


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Counterterrorism and Narcotics

Both terrorism and narcotics continue to be of high-priority interest among policymakers. This interest is reflected not just in the the Directorate's research program, but in its extensive ad hoc production and in the menus of interagency studies scheduled by the NIC. EURA itself has continued its series on the counterterrorism policies of West European Governments



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### Eastern Europe's Links with the USSR

US policymakers need a better understanding of the nature, types, and strengths of the economic ties that bind Eastern Europe to Moscow. These links help establish the range of flexibility for the East Europeans in dealing with the West, managing their economies, and formulating their domestic and foreign policies. Strains between the Soviets and their allies have intensified in recent years across a broad range of issues. Moscow's efforts to obtain more East European resources to ease its own economic problems exemplify these tensions, which have directed attention to the foundations of the relationship and raised the issue of whether fundamental changes are in train--changes which could offer either opportunities or serious challenges for US policymakers.

In the past year, EURA and SOVA created a task force to do research on CEMA, particularly the material linkages among the Soviet and East European economies and the contribution that East European industry can make to Moscow's economic and military capabilities. A number of studies nearing completion approach these problems from various angles, exploring Soviet bilateral ties with East Germany and Poland, analyzing trends in Soviet-East European trade flows, and assessing the East European contribution to two Soviet industries--nonfood consumer goods and microelectronics. Research in 1986 will continue and extend this work by examining a third bilateral relationship--USSR-Romania--and by completing surveys of Soviet-East European trade in machinery and equipment, chemicals, and consumer goods. These studies provide background for the central question facing analysts of Eastern Europe: What are Soviet-East European relations likely to be in the Gorbachev era?

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We have completed external research projects on the CEMA electricity grid, East European use of Soviet oil and gas, and intra-CEMA trade pricing. A project on the role of the steel industry is in progress. Our studies of intra-CEMA economic relationships will also benefit from the databases being developed under a major contract, one of whose goals is to construct standard datasets for all the East European countries. We will expand our use of external contractors to assess East European capabilities in such sectors as robotics and automated manufacturing systems, chemicals, metallurgy, the motor vehicle industry, and new industrial materials. We also will consult closely with analysts at the Department of Energy and Los Alamos National Laboratory who are examining the potential for energy conservation in Eastern Europe, and with analysts [redacted] who are looking at CEMA's role in chemical and biological warfare. Research under this theme is responsive to NITs 1E, 13C, and 25A2.

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### The East European Economies: Reform, Discipline, or Status Quo?

Although it has recovered to some extent from the debt crisis of the early 1980s, Eastern Europe must still cope with fundamental economic problems. Continuing financial pressures and declining Soviet support mean that the regimes cannot count on large resource flows from either the West or the USSR; indeed they are likely to face increased demands on them from Moscow. At the same time they must constantly juggle the need to allocate resources both to investment--critical for long-term economic performance--and to consumer goods--critical for short-term political stability. To meet the economic challenges facing them, the East Europeans must either get more productivity out of their present systems or embark on a measure of market-oriented reform. Resistance to reform remains strong in the parties and bureaucracies as well as among workers concerned about unemployment and inflation. Moreover, Moscow has recently given pointed warnings that market-oriented reforms are not the appropriate direction for change in "socialist" economies.

Over the last several years, EURA's research has covered Eastern Europe's debt problems, the impact on the domestic economies, and the evolution of Hungary's potentially far-reaching program of reform. In FY 1986, we will expand our work on innovation and reform with studies of Bulgaria's reform program and of East Germany's reasonably successful system of economic management. EURA will complete its baseline series on East European adjustment to financial problems with an assessment of Romania's performance, and will examine prospects for systemic change in the region. A study of East European investment policy will look at the impact of recent investment cutbacks on sectoral development and on growth prospects. A study of East European export competitiveness in the West will assess the changes occurring within the region's economies to improve hard currency trade performance. Both of the latter projects will of course consider the extent to which reforms in the traditional ways of doing things are considered desirable or permissible in Eastern Europe.

Because of the complexities and conceptual problems involved in using East European economic data, we have given priority to the development of quantitative tools. Working extensively with contractors, EURA has already developed several databases, and country models, a model for examining the trade-off between domestic resources and imports in the Polish economy, and a model for projecting East European trade with the West. In 1986, still in close collaboration with contractors, we will refine the existing analytic tools and expand our capabilities through development of balance-of-payments spreadsheets for financial analysis of individual countries, a data base on commodity prices in trade with the West, use of the Polish economic model to examine trade linkages between Poland and the USSR, extension of the foreign trade model to provide forecasts for Soviet-East European trade, and development of a model to examine the use of domestic resources and imports in the Hungarian



economy. We will continue our longstanding effort to reconstruct GNP accounts of each East European country in a manner consistent with Western concepts. These data series are the standard economic indicators for Eastern Europe used by the US Government and Western academic researchers.

EURA has sought to expand its contacts with private researchers in recent years through conferences examining economic and financial problems in the region and the use of quantitative analysis in research on the East European economies. In 1986, we will continue to promote an exchange of information and analysis with the academic community, invite more expert critique of our work where feasible, and draw on private sector research capabilities through external contracts. Research under this theme is responsive to NITs 1E, 13C, and 25A2.

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### Political Stability and Instability in Eastern Europe

In March 1984 the intelligence community published an NIE, "Pressures for Economic and Political Change in Eastern Europe," which painted a gloomy future for the region. It said the prospects for any appreciable recovery in the near term from the economic setbacks of the early 1980s were quite slim. Most East European societies were said to suffer from widespread popular disaffection, the product not only of economic deprivation but also of deep political discontent and frustrated feelings of nationalism. Eastern Europe's aging leaders seemed unable or unwilling to come up with remedies, and the estimate predicted political crises in one or more East European states before the decade is out.

Most of our contacts in the academic and policymaking worlds would agree that this judgment is still true--and indeed that the changes in Moscow may make it true in spades. Under the cautious Soviet leadership of the last two decades, East European leaders played by a well understood set of rules; they also benefited from substantial Soviet subsidies. The economic relationship is changing drastically--as our studies listed elsewhere in this program document--and at the same time there is a fair chance that the rules will become less clear under Gorbachev. These uncertainties will feed on well documented popular discontent; the leaders that deal with them will be either elderly or untried. The mixture could be volatile.

To assess the prospects for continuity or unrest we will first concentrate on the people and institutions that would attempt to contain any crisis. We intend to launch a long term research effort that will give us a better understanding of the political health and status of the East European Communist Parties. We are currently working on a region-wide survey of this problem which should be available in the first quarter of 1986. It has been labeled exploratory because we are not certain whether its findings will be more useful as a research tool for individual country studies or whether it will stand as an independent assessment. A separate study on the status of Romanian Communist Party is also scheduled for the first quarter.

We will be looking at other aspects of structural change in Eastern Europe as well: nationalism and regionalism in Yugoslavia, youth in Hungary and East Germany, social strains in Czechoslovakia, dissent in Hungary as reflected in the underground press. These efforts complement work being done elsewhere in the government, for example the scheduled INR study of the post-Kadar era. Research under this theme is responsive to NITs 1E and 13C.

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